Internal Control – Current and Future Perspectives

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Purpose

To provide an overview of the Policy on Internal Control:

- What it means to oversight of effectiveness of IC;
- Roles, responsibilities and accountabilities;
- The departmental experience;
- Government maturity on internal controls management; and
- Future directions
The Policy on Internal Control (PIC) flows from the Federal Accountability Action Plan to strengthen accountability and transparency in financial controls, reporting and disclosure:

- Supporting Deputy Heads (DHs) as Accounting Officers who are responsible for the “measures taken to maintain effective systems of internal controls” (section 16.4 of the FAA)
- Clarifying DHs responsibilities and expectations in this area
- Maintaining Canada’s position as a leader in financial reporting and disclosure

The PIC is a foundational component of the new TB FM framework articulated around four policies:

- Policy on Financial Management Governance (effective April 2009)
- Policy on Internal control (effective April 2009)
Canada among leading jurisdictions

- Federal Policy first in Canada

- Sarbanes-Oxley (U.S.): annual statement of management responsibility for assessing ICFR; disclosure of material weaknesses and action plans; explicit conclusion on effectiveness (certification); external auditor attestation on effectiveness; applies to federal institutions and companies

- Canadian Securities Administration

- Other leading jurisdictions – UK, Australia, Japan
Why the Policy is important

- Supports all accounting officer roles
- Supporting accountabilities clearly defined
- Integrity of financial information and disclosures
- Financial information supports decision-making
- Public and ministerial expectations of sound stewardship and oversight
- Enables the right controls for the right purpose
- ICFR base contributes to fully connected «system of internal control»
Requirements of the Policy on Internal Control

- Reaffirms the responsibility of Deputy Heads, as accounting officers, for ensuring the maintenance of effective risk-based systems of internal control

- With a focus on internal controls over financial reporting requires that Deputy Heads:
  - ensure the completion of an annual risk-based assessment of the departmental system of internal control over financial reporting (ICFR)
  - ensure the establishment of an action plan to address any necessary adjustments
  - include a summary of the assessment results and action plan to be attached as an Annex to a revised Statement of Management Responsibility accompanying the annual financial statements and signed by the DH and the Chief Financial Officer (CFO)
  - engage the Departmental Audit Committee or equivalent as appropriate on assessment plans and associated results
Levels of departmental internal controls

- **DH as accounting officer**
  - Broad system of internal control
- **CFO**
  - System of internal control over financial management
- **ADM**
  - System of internal control in their area of responsibility
- **Policy requirements focus on ICFR**

The diagram illustrates the hierarchical structure of internal control systems, starting with DH as the accounting officer, then CFO, ADMs, and finally policy requirements focusing on ICFR.
Roles and responsibilities

- **Deputy Heads (DH)**
  - As accounting officer, the DH is responsible for measures taken to maintain effective systems of ICs
  - Sign the *Statement of Management of Responsibility* which includes the Annex

- **Chief Financial Officers (CFOs)**
  - Lead departmental role for financial management (incl. a key source of expertise)
  - Lead and coordinate the planning and execution of the assessments and the Annex
  - Sign the *Statement of Management of Responsibility* which includes the Annex

- **Senior Departmental Managers**
  - Responsible for maintaining effective systems of ICs in the programs for which they are responsible
  - Contribute to the assessment of key risks and controls in their area of responsibility

- **Chief Audit Executives (CAE)**
  - Lead departmental role for internal audit (incl. a key source of expertise)
  - No internal audit required under the PIC
  - PIC assessment results can inform future internal audit plans
  - Internal audit findings can be leveraged to support the assessment under the PIC

- **Chief Information Officers (CIO)**
  - Lead departmental role for IT infrastructure and system applications (incl. a key source of expertise)
  - Contribute to assessments of IT systems and application controls

- **Departmental Audit Committees**
  - Provide objective advice and recommendations to Deputy Heads
  - Timing and scope of engagement to be determined by the Deputy Head
PIC success factors

• Senior Management commitment
• Roles and responsibility framework identified
• Leverage assessment coordination from the CFO’s office
• Leverage other oversight information (audits)
• Timeliness of completion of assessment steps
• Periodically revisit/update risk assessments and key controls identification
• Leverage efficiencies in processes and controls
• Disclosure of results and action plans
• Departmental communications/training on internal control management
Annual risk-based assessment approach

Financial Statements

Start with annual financial statements - Identify key accounts - key risks and materiality

- Set scope and develop assessment plan

### Testing

- **Design effectiveness:**
  - key controls documented
  - in place as designed
  - aligned with risks

- **Operational effectiveness:**
  - key controls functioning over time

### 3 levels of controls

- **Entity level (tone from the top)**
- **General IT level**
- **Business process level**
Internal Control – the departmental experience
Roles and Responsibilities

DM (Accounting Officer):
Broad system of internal control

CFO:
System of internal control over Financial Management

System of Internal Control

Internal Control over Financial Management

Internal Control over Financial Reporting

ADMs:
System of internal control in their area of responsibility
“Our Iceberg is Melting”
Resistance …

• Viewed as a ‘Financial’ issue
  – ‘auditable’ financial statements
  – Controls: defaults to s.33 Payment Authority

• Boondoggles?
  – HRSDC, not $1B in the end
  – PSAT, not $3.1B

• Managers are trained, so I will accept risk …
Change Management ...
Transactional or Cultural Change

- Transactional (Middle Management approach)
  - Fix documentation /Risk Matrices
  - Testing
  - Management Action Plans for remediation
  - Slow
- Culture Change (Drive from the Top)
  - Accounting Officer
  - Resources (incremental and outside finance)
  - ‘What gets measured gets done’
  - Proportionate
From the Top (Cultural)

• Accounting Officer
  – Ministerial accountability for Public Service anonymity was changed by the *Federal Accountability Act*

• Resources
  – Access to financial resources: this is an expensive process

• ‘What gets measured gets done’
  – Accountability to DAC and the Deputy Head will get the senior departmental managers to engage

• Proportionate
  – tickets for J-Walking
A Road Map

• Make it Real: a theoretical approach will not succeed
  – It’s all about the risk
    • Need to understand that there is personal risk
  – It will take longer than you think
  – Engagement is essential – not a financial exercise
  – Proportionate is key to securing buy-in
  – Use plans and reports to stay on track
    • Sub-certification checklists
    • Management Action Plans for remediation
OCG Current Expectations for PIC

- *Guideline for the “Policy on Internal Control”* provides expectations for departmental progress

- By the end of 2012-2013 large departments should be nearing completion of operating effectiveness testing and possibly ongoing monitoring in some areas; other departments should at least be advanced in design testing across some or all areas

- Departments subject to core control audits (CCA) – high risk financial transaction controls are being annually monitored and continue to perform as expected, publication of assessment results and action plan continues until CCA is conducted
OAG Follow-up Audit on Internal Controls over Financial Reporting

• Expect to be released in November 2013

• Audit of assessment progress of 7 departments and OCG’s monitoring role

• OGM a focus at this time

• OAG very interested in sound management of departmental internal controls. Expect further audits
Future Directions

• Five year review of the FM policy suite to be completed in 2014
• Focus to date has been on internal controls over financial reporting - system of ICFM as a base for broad system of IC
• Advancing Internal control frameworks in departments as a sign of maturity (governance, oversight, roles and responsibilities)
• MAF
• Future Policy changes to reflect increased maturity
TBS/OCG’s enabling role continues

• Guideline for the Policy on Internal Control”
• Working Groups – I and II
• Examples of IC Frameworks
• Practical Toolkit on Assessments
• Common Approaches Initiative
• June 12, 2012 Workshop materials
• Links to published annexes
• ITGC workshop in development
• GCPedia  http://www.gcpedia.gc.ca/wiki/PLIC
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Questions?